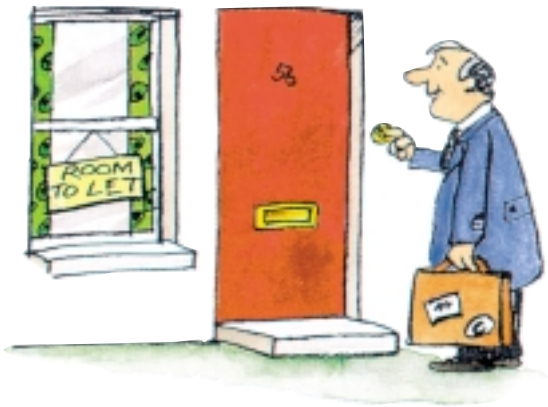
Personal Taxpayer Series
IR87

Inland Revenue

Letting and your home

Including the 'Rent a Room' scheme and letting your previous home when you live elsewhere



We produce a wide range of leaflets and booklets, each designed to explain a different aspect of the tax system in plain English. Most are free. Some you might find useful are listed below.

IR20	Residents and non-residents - liability to tax in the United Kingdom
IR90	Tax allowances and reliefs
IR123	Mortgage Interest Relief - Buying your home
IR140	Non-resident landlords, their agents and tenants
IR150	Taxation of rents. A guide to property income
IR283	Helpsheet. Private Residence Relief
CGT1	Capital gains tax. An introduction.

Our leaflet IR120 'You and the Inland Revenue' tells you more about the standard of service you can expect from us. It also tells you the steps you can take if you want to make any comments on the service you receive, or complain about the way your tax affairs have been handled.

Our IR List 'Catalogue of leaflets and booklets' gives further information about our publications, most of which you can get from any Inland Revenue Enquiry Centre or Tax Office. Their addresses are in your local phone book under 'Inland Revenue'. Most offices are open to the public from 8.30 am to 4.30 pm, Monday to Friday, and some are also open outside these hours.

Your local library or Citizens' Advice Bureau may also have copies of our leaflets.

You can get most of our leaflets and forms by

- calling our Orderline on **08459 000 404** between 8.00 am and 10.00 pm, seven days a week (except Christmas Day)
- by faxing **08459 000 604**
- by e-mail on s**aorderline.ir@gtnet.gov.uk**, or

- by writing to **PO Box 37**
  St Austell
  Cornwall
  PL25 5YN

Most of our leaflets are now available on the Internet @ **www.inlandrevenue.gov.uk**

When our offices are closed, you can get general advice by calling our Helpline, in the evening or at weekends, on **08459 000 444**.

Helpline and Orderline calls are charged at local rates.

This leaflet will help you if you are thinking about letting **furnished rooms** and want to know whether there will be any tax to pay on the income.

It describes the main tax rules that apply if you rent out rooms in your own home or let your previous home while you live somewhere else.

If you want to know about letting **unfurnished property** or letting property as **holiday accommodation**, staff at your Tax Office or any Inland Revenue Enquiry Centre will be pleased to help you.

We also publish booklet IR150 'Taxation of rents - A guide to property income' which is a detailed guide to income from property subject to income tax.

If you let more than one property at the same time, you should read no further. Instead, refer to booklet IR150. This booklet is also useful if you want further information on any points covered in this leaflet.

Will I have to pay tax?

This will depend on

- whether you come within the Rent a Room exemption scheme, and if you do not,

- whether your taxable income for any year, including any profit from letting, is more than your personal tax allowances.

If you are not sure what personal tax allowances you can claim, ask your Tax Office, or for our leaflet IR90 'Tax allowances and reliefs'.

On pages 16-20 of this leaflet we explain the rules that apply if you do not come under the Rent a Room scheme.

Rent a Room

The Rent a Room scheme has special rules that usually apply when you take in a lodger (broadly, a lodger is someone who pays to live in your home, normally with meals provided, and who often shares the family rooms).

This section describes the special rules which can apply when you rent out furnished accommodation in your only or main home. In other words, where friends and correspondents would expect to find you and your family. Your only or main home is the property which is the family home for most of the time.

Under the scheme, a certain amount of gross (that is, before expenses) income can be received tax free from furnished accommodation in your only or main home. You cannot, however, then claim any expenses, or capital allowances (see page 7).

For tax years 1992-1993 to 1996-1997, the first £3,250 of gross income can be tax free. From 1997-1998 the first £4,250 can be tax free. A tax year runs from 6 April one year, to 5 April the following year.

You do not have to take part in the scheme if it is not to your advantage. Instead, you simply declare all your letting income and claim expenses and, where appropriate, capital allowances in the normal way.

Throughout this leaflet all the figures are based on one person letting their house. If a house is let jointly each party will receive half of the given allowance.

For example from 1997-1998 if your letting income is less that £4,250 for the year it is tax free. However, if you are letting jointly, this figure will be halved - you will each be entitled to receive up to £2,125 without paying tax.

For further information about letting jointly see page 4.

Do the special rules apply only to owner occupiers?

No. They apply to people who rent as well as people who own their homes, but you should check whether your lease allows you to take in a lodger. If you have a mortgage you should check with your lender.

Do the rules mean I don't have to pay tax on the rent I get?

As long as the total rent you get during the tax year is no more than £4,250, you do not have to pay tax on that income. If your letting amounts to a trading activity, there are certain capital allowance considerations of which you must take account. These are explained on page 7.

If we do not send you a tax return and you receive rent of £4,250 a year or less, you do not need to tell us about this income. If you do get a tax return, all you have to do is tick a box to confirm that your rental income is £4,250 a year or less.

Do the special rules have to apply?

No, there may be circumstances where you will not want them to. For example, if you are treated as carrying on a trade, and exceptionally you made a loss, you might wish to set that loss against other income (see page 7).

You should let your Tax Office know by 31 January, 22 months after the end of the tax year in which the loss was made, that you do not wish to be within the Rent a Room scheme. (For years up to 1995-1996 inclusive, the time limit is one year from the end of the year in which the loss was made.)

What if I share the house where I live?

If you share your home with another person and one of you lets a room to someone, the whole exemption will go to the person actually renting out the room. If you let the room jointly, or you each let a separate room, each of you will get half the exemption, that is, £2,125.

If three or more people let a room on a joint basis, they will each get an exemption of £2,125 each.

Where a home is owned by a husband and wife, the income from letting will normally be treated for tax purposes in equal shares. If services such as meals and cleaning are provided, however, the letting will probably amount to a trade and the income will arise to the spouse who carries on the trade.

What happens if the rent is more than £4,250?

In that case you can choose between

A paying tax on the profit you make from letting the room, worked out in the normal way, or

B paying tax on the amount of rent over £4,250.

If you choose method A, you need to work out your profit by taking your actual expenses away from the total rent you receive. If you decide on this option, read pages 9-10 which explain the expenses you may claim.

If you choose method B, you will pay tax on any amount of rent over £4,250 (including payments for any related services you provide - see page 7). If you decide on this option, you will need to tell your Tax Office by 31 January, 22 months after the end of the tax year, that you wish to be within the Rent a Room scheme and be taxed on the amount of letting income your receive over £4,250. So if you had income from letting a room during the tax year ended 5 April 2000 you must tell us by 31 January 2002 that you want to be taxed using this method. (The time limit for tax years up to 1995-1996 inclusive is one year after the end of the year.)

The time limits for advising us which method you wish to use are strictly applied, although we are able to extend them in certain circumstances.

If you wish to take part in the Rent a Room scheme but have, for some good reason, missed the time limit, you should consult your Tax Office.

How do I decide which method to choose?

You can choose whichever method is best for you. To do that you will need to work out how much profit you are making, in other words, how much rent you are left with after your expenses.
You should then compare that figure with the amount of rent over £4,250. Here are two examples to show you what we mean.

Example 1
Susan lets a room for £110 a week.
Her total letting income (rent) for the year is £5,720.

Method A.	She has expenses of £1,000, so her profit is **£4,720**.
Method B.	The amount of rent over £4,250 is **£1,470** (£5,720 – £4,250).

Using method A, she would pay tax on a profit of **£4,720**.
Using method B, she would pay tax on **£1,470**.

In Susan's case, method **B** is better.

Example 2
John also lets a room for £110 a week.
His total letting income (rent) for the year is £5,720.

Method A.	He has expenses of £4,500, so his profit is **£1,220**.
Method B.	The amount of rent over £4,250 is **£1,470** (£5,720 – £4,250).

Using method A, he would pay tax on a profit of **£1,220.**
Using method B, he would pay tax on **£1,470**.

In John's case, method **A** is better.

Can I change the method from year to year?

Yes. But each time you want to change you must tell your Tax Office by 31 January, 22 months after the end of the tax year.

Method B will automatically cease if the rent you get drops below £4,250. If, in the following year, your rent goes up and you want to use method B again, you must tell your Tax Office by 31 January, 22 months after the end of the tax year.

(The time limit for tax years up to 1995-1996 inclusive, is one year after the end of the tax year.)

I provide meals and a laundry service as well as accommodation. Does this affect my entitlement to Rent a Room relief?

No, but if you do provide these and any other related services, any payment you get for them has to be added to the rent for Rent a Room purposes. If the income you receive from total rent and services is more than £4,250 a year, **even if the rent alone is less**, you will have to pay tax. Your tax choice will be between method A and B shown on page 4.

Can I get relief for losses under Rent a Room?

Yes. If you have any losses outstanding from earlier years when your rents were not within the scheme, these can be included.

If your rent is £4,250 a year or less and you therefore have no tax to pay on that income, the losses from an earlier period can be carried forward against future letting profits.

If your rent is more than £4,250, then – whether you use method A or B – the earlier losses can be set against your rents by carrying forward the loss and setting it against your rental profits in future years.

I am treated as trading and can normally claim capital allowances. What happens if I use the Rent a Room scheme?

You cannot claim capital allowances on furnished lettings for any year in which you are within the Rent a Room scheme.

However, any balancing charge (this is basically a charge to recover capital allowances given in earlier years which may arise when, for example, you sell the equipment on which the allowance was given) will be

- added to your gross rents when deciding whether they are no more than £4,250 and therefore whether you are exempt

- taxable in the normal way if you use methods A or B as shown on page 4.

Will I have to pay capital gains tax when I sell my home?

The Rent a Room scheme makes no difference to the capital gains tax rules which apply when you sell your home. Special rules apply if you have let part or all of your home as residential accommodation - see pages 16 – 20.

What happens if I move home during the year?

We look at the **total** rent you receive during the tax year. If you move home, and lettings in both your old and new home qualify for Rent a Room relief during the same year, you must add together the rents from both to see if you need to pay tax.

What happens if I live abroad?

If you let your own home in the United Kingdom while you live abroad you will not normally be within Rent a Room. You should consult your Tax Office, especially if you were within Rent a Room before you left.

Furnished Lettings

If you do not come within the Rent a Room scheme, you need to know

- what expenses you can claim
- the tax reliefs available
- how the tax is collected and so on.

What expenses can I claim?

The most common allowable expenses are

- gas and electricity
- insurance premiums for buildings and contents
- maintenance and repair costs, but not the costs of improvements
- water rates
- rent, if you do not own the property
- the fees an agent charges to let your home for you
- council tax which you pay for the let property.

You can claim the expenses for the let part of your home. For example, if your house is in three storeys and you let the top floor you can claim

- one-third of the expenses incurred on the whole house, **plus**

- the full amount of the expenses incurred **solely** on the let part of the house, such as the cost of advertising for tenants.

Mortgage interest is not an allowable expense against your income from letting if you are claiming mortgage interest relief – see page 11.

Payments made by members of your family towards household expenses are not taxed.

Please contact us if there is anything you are not sure about – contact details are given on the inside front cover.

What if these expenses are incurred before I start to let the property?

You may be able to claim relief for these if they

- are incurred in the period beginning seven years before the date you started the letting, and
- the expenses would have been allowable if you had already started the letting.

The relief works by treating the expenses as incurred in the first year of letting.

Your Tax Office will be able to help you with this if you are not sure.

What about the cost of furniture?

You cannot claim the cost of furniture when you first buy it, but you can choose to claim the actual cost of furniture when you replace it (after deducting the cost of any improvements and anything received on the disposal of the old furniture), or a 'wear and tear' allowance. The 'wear and tear' allowance is 10% of the annual rent after deducting any part of the occupier's council tax, water rates, and any other service charges which are normally paid by a tenant but which are paid by you.

Once you have made a choice you cannot change it.

My expenses are more than the income I receive from the letting. Can I claim the difference against the rest of my income?

You can get relief by carrying forward the deficit (the loss) and setting it against profits you make from both furnished lettings and unfurnished lettings in future years.

If you, however, stop letting and there is a gap before you begin letting again, you may not be able to carry forward any earlier losses. If your property is temporarily unlet but remains available for letting throughout, you will normally be able to carry forward losses when the letting resumes.

Will my mortgage interest relief be affected?

Not usually, but it depends on your circumstances, particularly the proportion of your home that you let.

Mortgage interest relief is being withdrawn from April 2000. Therefore the following applies only for mortgage interest paid before 6 April 2000.

If you have been getting relief under the MIRAS scheme (mortgage interest relief at source), you can normally continue to get relief if you do not let more than one-third of your home. (If you start to let more than one-third of your property, you should tell your lender and your Tax Office straight away). Similarly, if you have been getting relief outside the MIRAS arrangements, you can normally continue to get relief.

You may also be able to get relief by setting the interest you pay against your property income, but you cannot have both forms of relief and you should choose whichever form of relief if better for you. If you want more information about this, please see leaflet IR150 'Taxation of rents – A guide to property income'.

What happens if I let my whole house?

The basic rules are the same if you let your whole house, furnished, while you live or work elsewhere. Again, if you are getting mortgage interest relief you may choose whichever form of relief is better for you.

What records should I keep?

You must keep a careful note of the rents you receive and any expenses as they arise. You must retain these records, together with back-up records such as receipts and invoices for six years after the tax year in question. These will help you if your Tax Office decides to make enquiries into your tax return.

What information will the Tax Office need?

If we send you a tax return you should complete it and send it back at the latest by 31 January after the tax year in question. For example, you will have to send your completed tax return for the year ended 5 April 2000 to your Tax Office by 31 January 2001. You should enter the amount of rents you have received in the tax year and the expenses which you have paid on the tax return.

If you do not receive a tax return, please write to your Tax Office and they will send you one.

How is the income tax collected?

From 1996-1997 income from property will be included in your Self Assessment to tax on all of your income. For example, for 1999-2000 two payments on account will be due, the first by 31 January 2000 and the second by 31 July 2000. Each payment on account is one half of the income tax bill for 1998-99. If the payments on account are less than the amount finally due for 1999-2000, you must pay the balance by 31 January 2001. (Special tax rules apply for 1996-1997.)

However, if you are employed and the amount taxable in respect of your property income is less than £1,000, your Pay As You Earn (PAYE) tax code will probably be adjusted to collect the tax due on your property income each year.

What if I live abroad?

You have to pay income tax on the rent if you let your previous home in the United Kingdom (UK) while you live abroad.

Your letting agent, or your tenant where there is no letting agent, must deduct tax from your rental income and pay that tax to the Inland Revenue. You can then set off that tax against your personal tax bill when you complete your tax return.

The deduction of tax will not apply

- where there is no agent and the rent paid is less than £100 per week, unless the tenant has been told to deduct tax by the Inland Revenue

- where the Inland Revenue has issued a notice confirming that rents may be paid without deduction. You can apply to receive rental income without deduction of tax on the grounds that you do not expect to be liable to UK tax, or your UK tax affairs are up-to-date and you will pay all tax due through Self Assessment.

For further guidance on the deduction scheme and how to apply to receive rents without paying tax, ask your Tax Office, or see our leaflet IR140 'Non-resident landlords, their agents and tenants'.

What happens if I take in a lodger and do not claim Rent a Room relief?

You will be entitled to extra relief for additional expenses which are normally involved.

The extra services you may provide while you remain living at the same address, such as meals and laundry, mean that you will normally be treated as carrying on a trade for tax purposes. In practice, this makes little difference to the way you calculate your taxable income. You can still claim the same sort of expenses as if you were letting furnished rooms. In addition, you can claim the cost of providing the extra services and you may also be entitled to some other tax reliefs, described below.

- **Capital allowances**
  These replace the wear and tear allowances, or deductions for the costs of replacing furniture, given to people who let furnished rooms.

- **Additional loss relief**
  If in any tax year your expenses are more than the rent you receive, you may be able to claim the difference (the loss) against the rest of your income.

Your Tax Office will be able to tell you more about these reliefs.

Will I have to pay capital gains tax when I sell my home?

Special rules apply if you have let part or all of your home as residential accommodation, see pages 16 – 20.

Capital gains tax

When you sell a property you may have to pay capital gains tax (CGT) – not on the whole amount you sell it for but on the gain you make in selling it.

However, there are various tax reliefs available. See our leaflet CGT1 'Capital gains tax – An introduction' and our Help Sheet IR283 'Private Residence Relief' for more information on this. Below, we look at the main effects on CGT where you have let all or part of the property you sell.

What happens if I sell my home?

You do not have to pay CGT when you sell your home if you are the owner (or co-owner) of the property and you occupied the whole of it as your home throughout the time you owned it. Instead, you get a relief from CGT called the **private residence relief**. Our leaflet CGT1 'Capital gains tax – An introduction' and our Help Sheet IR283 'Private Residence Relief' gives more details.

What happens if I have a lodger?

The **private residence relief** is not affected if you have a lodger who is treated as a member of your family, sharing the living rooms and eating with you, even if he or she has a separate bedroom.

What happens if I let my home?

If you let

- part of your only or main home while you owned it, or
- all of your home for part of the time you owned it

to someone who is not treated as a member of your family, you may have some capital gains tax to pay when you sell it.

In other words, the amount of **private residence relief** will be affected, depending on

- how much of your home you let, and
- the length of time you let it.

In addition, you may be entitled to a special **lettings relief**.

What is lettings relief?

If you let part or all of your home as residential accommodation, relief is available on the gain which would otherwise become chargeable as a result of the letting, up to the lower of

- the private residence relief due to you, or
- £40,000

How do I decide if the let accommodation is part of my home?

Is the accommodation you have let part of your home, or a separate dwelling? For example, if you let part or all of a single dwelling which has been your home, without making structural alterations or with only minor changes, the let part will not be treated as a separate dwelling-house. This applies even if the let part has its own areas for washing and/or cooking. You will receive the lettings relief in these circumstances.

If you occupy a self-contained flat as your home within a building and let all or part of the rest as residential accommodation you will not get the lettings relief.

If the building is altered so that the let part of it becomes a fully self-contained flat (whether or not it is treated as a separate dwelling-house), you will not get the lettings relief.

Do I get any other relief from capital gains tax when I have let property?

If you qualify for private residence relief on any part of your property at any time, you will also qualify for this relief for the last three years in which you owned it.

The following examples show how these CGT rules work. In each example the let parts are let as residential accommodation.

Example 1
John Smith sells his house in 1999 after owning it for eight years. During that time he occupied one-sixth (1/6) of the property as his home and let the other five-sixths (5/6). His gain is £60,000.

John occupied 1/6 of the property so the proportion of the gain which qualifies for private residence relief is 1/6 x £60,000 = £10,000.

John also qualifies for the lettings relief because he let part of his house. The lettings relief is the lower of the principal private residence relief due to him (£10,000) or £40,000. So he gets lettings relief of £10,000.

Gain			£60,000
Less	– private residence relief	£10,000	
	– lettings relief	£10,000	
			£20,000
Chargeable gain			**£40,000**

Example 2

Mary Jones sells her house in 1999 after owning it for 10 years. During that time she occupied two-fifths (2/5) of the property and let the other three-fifths (3/5). Her gain is £140,000.

Mary occupied 2/5 of the property so the proportion of the gain which qualifies for private residence relief is 2/5 x £140,000 = £56,000.

Mary qualifies for the lettings relief because she let part of her home. The lettings relief is the lower of £56,000 or £40,000, that is, £40,000.

Gain			£140,000
Less	- private residence relief	£56,000	
	- lettings relief	£40,000	
			£96,000
Chargeable gain			**£44,000**

Example 3

The facts are the same as in Example 2, except that Mary occupied the **whole** of her property for two years before letting the whole of it for the remaining eight years. In this case she is treated as occupying the whole property for the last three years of her ownership.

The proportion of her gain which qualifies for private residence relief is

$$\frac{\text{first 2 years + last 3 years}}{\text{10-year period of her total ownership}} = \frac{5}{10}$$

5/10 x £140,000 = £70,000

The lettings relief is the **lower** of £70,000 or £40,000, that is, £40,000.

Gain			£140,000
Less	- private residence relief	£70,000	
	- lettings relief	£40,000	
			£110,000
Chargeable gain			**£30,000**

Example 4
The facts are the same as in Example 3, except that, after occupying the whole of her property for two years, Mary let three-fifths (3/5) of the property for the remaining eight years. Again, she is treated as occupying the whole property for the last three years of her ownership.

The proportion of her gain which qualifies for private residence relief is

$$\frac{\text{first 2 years + (2/5 of the next 5 years) + last 3 years}}{\text{10-year period of her total ownership}} = \frac{7}{10}$$

7/10 X £140,000 = £98,000

The lettings relief is the **lower** of £98,000 or £40,000, that is, £40,000.

Gain			£140,000
Less	- private residence relief	£98,000	
	- lettings relief	£40,000	
			£138,000
Chargeable gain			**£2,000**

Advice on CGT

If you need any further help about how capital gains are calculated, your Tax Office will be able to supply further details.

Further information

This leaflet may not cover every point that interests you. If you require further information please speak to our staff at your Tax Office or any Inland Revenue Enquiry Centre. Details of how to find your nearest office are given on the inside front cover.

If you want to know more about the general laws on letting rooms, ask your nearest Citizens' Advice Bureau for a copy of the DETR leaflet 'Letting Rooms in Your Home'.

Our service commitment to you

The Inland Revenue and Customs & Excise are committed to serving your needs well by

acting fairly and impartially

We
- treat your affairs in strict confidence, within the law
- want you to pay or receive only the right amount due.

communicating effectively with you

We aim to provide
- clear and simple forms and guidance
- accurate and complete information in a helpful and appropriate way.

providing good quality service

We aim to
- handle your affairs promptly and accurately
- be accessible in ways that are convenient to you
- keep your costs to the minimum necessary
- take reasonable steps to meet special needs
- be courteous and professional.

taking responsibility for our service

- We publish annually our customer service aims and achievements
- If you wish to comment, or make a complaint, we want to hear from you so we can improve our service. We advise you how to do this.

We can provide better service if you help us by

- keeping accurate and up to date records
- letting us know if your personal/business circumstances change
- giving us correct and complete information when we ask for it
- paying on time what you should pay.

Further information on customer service is available at Inland Revenue and Customs and Excise local offices, set out in our Charters, complaints leaflets (IR120 and Notice 1000) and Codes of Practice.

These notes are for guidance only and reflect
the tax and NICs position at the time of writing.
They do not affect any right of appeal.

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